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No. 01-656

IN THE

Supreme Court of the United States

A.D. BEDELL WHOLESALE COMPANY, INC., TRIANGLE CANDY & TOBACCO CO., on behalf of themselves and all others similarly situated,

Petitioners,

v.

PHILIP MORRIS INCORPORATED, R.J. REYNOLDS TOBACCO COMPANY, INC., BROWN AND WILLIAMSON TOBACCO CORP.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF

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CORPORATE DISCLOSURE STATEMENT

Petitioners' corporate disclosure statements were set forth at page *ii* of the Petition for a Writ of Certiorari, and there are no amendments to those statements.

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Petitioners hereby reply to Respondents' brief in opposition as follows.

PRELIMINARY STATEMENT

Contrary to the argument of the Majors, whether the members of a nationwide output cartel controlling virtually the entire sales of cigarettes attain antitrust immunity by setting up that cartel in a settlement agreement with a group of states, does not present some run-of-the-mill application of the *Noerr-Pennington* doctrine. The ruling below conflicts with the decisions of this Court. A definitive resolution of the issue is required not only to judicially validate or, alternatively, condemn the overcharges of billions of dollars per year from purchasers of cigarettes enabled by the cartel, but to determine whether it should serve as a valid template, in the words of the states attorneys general to conduct "meaningful settlement negotiations" with the major players in other oligopolistic markets.

The Complaint Properly Pleads An Illegal *Per Se* Output Cartel

In the courts below, the Majors sought to justify the output cartel by arguing that it was an ancillary restraint, lawful under the rule of reason. In their brief in opposition here, they now take the position that they are not operating an output cartel at all (Br. 4).[1] The complaint, however, carefully spells out how the Majors have operated the output cartel using the penalties provided in the MSA for exceeding market share allocation work to produce a drastic restriction in output (JA 59-71), and the Opinion succinctly summarizes those penalties and output restrictions. (Pet. App. at 9a-15a).

Significantly, the Majors do not contend in this Court that their engaging "in post-MSA price-fixing without the 'active supervision' of the States" would attain antitrust immunity.

1. References herein to "Br. __" are to Respondents' brief.

(Br. 22). However, according to the Majors, because the petitioners did not allege any price-fixing, they assert that $10.00/carton price rises enabled by the output restrictions in the MSA are beyond challenge. (Br. 22). As this Court explained in *California Dental Ass'n v. FTC*, 526 U.S. 756 (1999), however, it is black letter law that output restrictions are as pernicious as price fixes: "An agreement on output also equates to a price-fixing agreement." *Id.* at 777 (quoting *General Leaseways, Inc. v. National Truck Leasing Ass'n.*, 749 F.2d 586, 594 (7th Cir. 1984)).

The Majors' *Noerr-Pennington* Arguments Conflict With the Established Decisional Law of this Court

1. *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365 (1991) ("*Omni*")

The Majors seize upon the obvious and incontrovertible proposition recognized in *Omni* that there is no conspiracy exception to the *Noerr-Pennington* doctrine,[2] to argue that they are protected under *Noerr-Pennington*, even if they "allegedly conspired with the government," citing *Omni* at 382-83 (Br. 11). This is a classic example of faulty logic. The Majors proceed to conclude from the premise that there is no conspiracy exception to *Noerr-Pennington*, that the Majors are thereby free to conspire with the States by committing acts that are not part of the petitioning process. *Omni* itself, however, refutes the very proposition urged by the Majors. In holding that the States may not "exempt a *private* action from the scope of the Sherman Act" (emphasis in original), *id.* at 379, this Court stated:

> ". . . we in no way qualify the well-established principle that 'a state does not give immunity to those

2. As pointed out in *Omni*, *id.* at 375, by definition a restraint of trade illegal *per se* under § 1 requires an agreement or, because it is illegal, a "conspiracy." Thus, a conspiracy exception to *Noerr-Pennington* would totally abolish that protection where, as usual, a § 1 charge is involved.

> who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." *Parker*, 317 U.S. at 351, 63 S.Ct., at 314 (citing *Northern Securities Co. v. United States*, 193 U.S. 197, 332 (1904)). See also *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384 (1951).

Ibid.

The issue now before this Court is whether the States, by making the settlement agreement with the Majors can authorize them to violate the Sherman Act. The opinion of the Third Circuit holds that they can, and this clearly conflicts with *Omni*.

2. *United Mine Workers v. Pennington*, 381 U.S. 657 (1965) ("*Pennington*")

In another example of twisted logic, the Majors argue that because *Pennington* held that because the protected petitioning process was "'part of a broader scheme' to achieve an anticompetitive goal" (Br. 11), therefore the operation of this cartel set up in the MSA is entitled to *Noerr-Pennington* immunity. As pointed out in the Petition (p. 15), however, *Pennington* held precisely the contrary. *Id.* at 663.

3. *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979) ("*BMI*")

The Majors apparently concede that a restraint of trade embodied in a settlement agreement between private parties is not entitled to *Noerr-Pennington* immunity, but contends that such a restraint does obtain *Noerr-Pennington* immunity when made in a settlement agreement with a governmental body. (Br. 13). *BMI* flatly holds that such a restraint in a settlement with a governmental agency, there the Department of Justice, does not immunize the private parties from antitrust liability, even though the Antitrust Division had covenanted in the settlement not to attack it.

Although the Majors do not attempt to defend the primary reason advanced by the Opinion for holding *BMI* inapposite, namely, that it did not involve a settlement agreement, (Pet. App. at 30a), they advanced three other reasons why *BMI* is inapplicable (Br. 13):

a. The conduct challenged in *BMI* carrying out the restraints authorized in the agreement "occurred years *after* a government decree was entered into;" (emphasis in original)

b. The decree did not require defendants in *BMI* to engage in the challenged conduct; and

c. The concept of *Noerr-Pennington* immunity was not addressed in *BMI*.

None of these reasons withstand analysis. As to the first, the Majors do not explain why conduct engaged in "years after" the settlement agreement becomes illegal. In point of fact, under the MSA, the Majors are required to make annual settlements to the States in perpetuity or, more realistically, as long as they are able to efficiently operate the output cartel. What the decision below does is in effect to grant them a perpetual license to operate that cartel, or at least lasting for "years after" the MSA was executed.

As to the second reason, nothing in the MSA "requires" the defendants to engage in massive price increases. They do so because they are dedicated to reaping the full benefits of the cartel.

As to the third reason, namely the lack of an argument in *BMI* that *Noerr-Pennington* protection arose out of the *BMI* settlement agreement, the Majors do not argue that the parties or tribunals involved in that case were unaware that petitioning the federal government is protected under *Noerr-Pennington*. That the notion of first amendment protection for the restraint

set up in the consent decree was never discussed by anyone merely underscores its inherent irrationality.

The major difference between *BMI* and this case is that in *BMI*, unlike here, the government agency involved, the Department of Justice, did not benefit from the restraints set up in the settlement agreement.

Finally, the Majors persist in asserting that *Campbell v. City of Chicago*, 823 F.2d 1182 (7th Cir. 1987), held that post-petitioning conduct was entitled to *Noerr-Pennington* protection. As pointed out in the Petition, however (pp. 23-24), the *Noerr-Pennington* protection in that case was limited *solely* to the process of the taxicab operators' jointly petitioning the local government through litigation and lobbying legislation. The Seventh Circuit explicitly adjudicated the issue of antitrust immunity for the post-petitioning acts of the taxicab operators under *Parker v. Brown*.

In summary, the Majors can point to *no* authority of this Court which even purports to apply First Amendment petitioning protection to immunize the illegality of restraints carried out after that petitioning process was completed. There is likewise *no* authority which extends such protection to post-petitioning acts done pursuant to a settlement agreement made with a governmental body, as opposed to one made between private parties. The notion that the major firms controlling a market can with impunity operate an output cartel by virtue of its framework is being inserted in a settlement decree conflicts with the decisions of this Court discussed above and presents a clear threat to the economic freedoms guaranteed by the Sherman Act.

4. *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 484 U.S. 492 (1988) ("*Allied Tube*").

The Majors seek to distinguish *Allied Tube* by arguing that the antitrust injury inflicted in that case "resulted from purely

private conduct." (Br. 15). They then incorrectly assume that the harm petitioners sustained was caused by governmental action and thus protected under Noerr-Pennington. The Opinion, however, explicitly held that the antitrust injury sustained by petitioners resulted from private conduct. (Pet. App. at 21a-22a).

The *Noerr-Pennington* doctrine provides no immunity for anticompetitive conduct by private actors, either standing alone or with the additional participation or acquiescence of states or state officials. State participation in, approval or regulation of private anticompetitive conduct — unlike the request to engage in such conduct — is governed by the state action doctrine. Private anticompetitive conduct claimed to be protected because of state approval must be clearly articulated as state policy and closely supervised by the state. If it fails in either respect, it does not qualify as state action and is subject to antitrust scrutiny; and the fact that private actors "petitioned" a state for authority to engage in such conduct does not and cannot change this result.

The Immunity For Illegal Post-Petitioning Conduct Is Governed by the State Action Immunity Doctrine

In an effort to create a spurious issue, the Majors incorrectly assert that the petitioners make a "fundamentally mistaken assumption that *Noerr-Pennington* immunity cannot apply to Respondents' conduct if *Parker v. Brown* 'state action' immunity does not also apply to such conduct." (Br. 16). Petitioners made no such assumption. As discussed above, petitioners merely endorse the obviously correct proposition that post-petitioning conduct cannot be immunized by the constitutional protection for the *process* of petitioning. Having misstated our position in this fashion, the Majors then go on to argue that because the *Noerr-Pennington* doctrine does not require active supervision by the States, they, therefore, can carry out with impunity their illegal acts implementing the output cartel. (Br. 17-19). This illogical argument reinforces the lack of rationality of the Majors' position. Obviously, a government agency to whom the petitioning process is directed does not actively supervise that

petitioning process. What the Majors in essence are arguing is that because a group of competitors can petition a local or state governmental agency to authorize acts which are patently illegal under federal law, obtaining such authorization gives that group the right to proceed to commit post-petitioning acts not protected by state action immunity. There has never been any decision endorsing such a position.

The State Action Immunity Doctrine Does Not Authorize the Implementation Of the Nationwide Cigarette Output Cartel

The alternative ground urged by the Majors for not granting the Petition is that their conduct is clearly protected under *Parker v. Brown,* 317 U.S. 341 (1943). This position is incorrect for two reasons.

First, the Majors assume, without discussion, that *Parker v. Brown* is an *interstate* immunity doctrine. It is not. Although the Third Circuit did not address this threshold proposition, it seems reasonably self-evident that *Parker v. Brown* does not protect the operation of an *interstate* cartel. As *Parker v. Brown* itself emphasizes, *id.* at 361-62, the doctrine was formulated to protect restraints essentially authorized under local or state regulation.

Second, according to the Majors, the Third Circuit erred in holding that the Majors' post-petitioning conduct in implementing the output cartel could not qualify for state action immunity because those acts were done without any supervision by the States and hence did not meet the "active supervision" prong of *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) ("*Midcal*"). According to the Majors, the Third Circuit reached this conclusion because it erroneously ruled that the Majors could "theoretically engage in post-MSA price-fixing without the 'active supervision' of the States." (Br. 22). The Third Circuit made no such ruling. What it did was make a careful review of the price rises that the

diligent enforcement of the output cartel enabled the Majors to make. (Pet. App. at 46a, 57a). In essence, what the Majors are arguing is that because the petitioners did not charge price-fixing, the active supervision prong of *Midcal* does not apply to their implementation of the output cartel. As explained above, once an output cartel is efficiently and thoroughly implemented, as is the case here, there is no need for the conspirators to agree among themselves to raise prices. Having choked off the supply, they are free to exploit the inelasticity of the demand. That is why output cartels, like price fixes, are illegal *per se*. The basic question before this Court is whether the Majors shall remain free to do so.

There Was No Waiver of the Constitutional Arguments

The Majors do not dispute that the petitioners argued in both courts below that the affirmative defenses of First Amendment petitioning protection and state action immunity were insufficient as a matter of law because the output cartel set up in the MSA and implemented by them violated the dormant Commerce Clause, was preempted by the Sherman Act and was a product of an unconstitutional and unauthorized interstate compact. The Majors advance no reason, plausible or otherwise, why the petitioners were obligated to anticipate the affirmative defenses of *Noerr-Pennington* and *Parker v. Brown* and set forth legal arguments in their complaint as to why these affirmative defenses, if raised, would be legally insufficient. They simply refuse to come to grips with this obvious and basically unanswerable point of rudimentary pleading.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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